STATEMENT

Insurance Association of Connecticut

Insurance and Real Estate Committee

February 3, 2011

SB 32, An Act Prohibiting Offsets For Retirement Benefits In Disability Income Protection Policies

The Insurance Association of Connecticut opposes SB 32, An Act Prohibiting Offsets For Retirement Benefits In Disability Income Protection Policies, which would prohibit group and individual long-term disability (LTD) insurance policies from offset provisions relating to retirement benefits.

The purpose of LTD insurance is to provide replacement income to eligible individuals who become disabled, equal to some pre-designated percentage of their pre-disability income. In addition, standard provisions establish an offset, to be subtracted from the policy benefit, for certain defined sources of additional income. The claimant still receives the same percentage of their pre-disability income, but in the aggregate from multiple sources.

Offset provisions are accepted as a product of sound policy design and cost considerations and are approved across the nation by state regulators. LTD policies are priced with the actuarial assumption that a portion of eligible claimants will have benefits offset by other income. That assumption allows LTD policies to be more affordable. Any statutory restrictions or prohibitions regarding the use of offsets will cause a corresponding increase in the cost of the policy.

The typical plan design for a group LTD policy provides for a benefit of 60% of the insured's pre-disability income. Part of the reason for designing LTD plans with a maximum benefit amount is to encourage a return to work when the claimant's health condition permits.

Insurers use offsets in group LTD policies in order to control costs and to ensure that the claimant's post-disability income does not approach or exceed his or her pre-disability earnings. It would be counterproductive for an employer to voluntarily establish an LTD program for its employees that would in effect create a financial incentive for them to remain on disability longer than necessary, and would further increase costs.

Subsection (c) in section 1 would prohibit offsets for retirement benefits in group LTD policies. Currently insurers may offset for retirement benefits paid for by the employer, such as defined benefit plans. However, insurers do not offset for benefits from 401k plans that the employee funds.

Group LTD insurance is usually provided through employers, who may pay up to 100% of the premium. Years of selling LTD policies has shown insurers that it is an extremely price-sensitive market, since LTD insurance is a voluntary coverage. It is estimated that, by prohibiting offsets for retirement benefits, SB 32 could increase the cost of group LTD by up to 10% or more, with the actual increase depending on the specific group. This increase would apply to all group members.

In subsection (c) of section 2, individual LTD policies would be subject to the same offset prohibitions for retirement benefits as in section 1. Individual LTD policies are bought by individuals and usually tailored to their particular needs. Benefit levels may be set at a percentage of income or at a flat dollar amount that is set with the individual's income in mind. The applicant usually has the option, by rider, to choose whether the policy contains offsets or not. By choosing an offset product, the applicant can save premium dollars. By prohibiting retirement benefit offsets, SB 32 would take away some of that flexibility from consumers, limit choice and prevent opportunities for premium savings, creating disincentives to buy the individual LTD product.

Individual LTD policies can also be sold on a "group platform". An employer may arrange for its employees, usually lower wage earners, to have the option of purchasing individual policies whose terms have been pre-set according to the employer's design, including offsets. The policy would be less expensive for the employee than if he or she tried to buy a policy as an individual, due to the economies of scale. In such an arrangement, the employee also benefits from the fact that he or she can take the policy when leaving that particular job, and can continue to pay the lower rates.

SB 32 will create a disincentive for employers to set up such an option, as statutory restrictions on offsets would create the possibility of overinsurance, creating financial disincentives for employees to return to work. Premium costs of the products will go up due to the absence of offsets, creating less reason for employees to buy the product, resulting in less protection for their families in the event of disabilities.

IAC would ask the Insurance Committee to consider the public policy implications of SB 32.

- Less than 40% of employees across the country have private LTD coverage (group and individual).
- Statistically, three out of every ten workers will, before they retire, face a disabling condition that prevents them from working.

- In 2009, for the first time less than half the employers who provided LTD policies paid for or shared in the cost of the policy premiums.
- Disability claims are pouring into the Social Security Administration in record numbers. This has led to much larger case backlogs, resulting in longer delays for eligibility determinations for SSDI.
- LTD policies cover claims that SSDI does not. Over 30% of individuals receiving LTD benefits don't qualify for SSDI.

By eliminating LTD offsets for retirement benefits, SB 32 would (1) increase the cost of LTD policies, giving employers and/or individuals less incentive to purchase the coverage; (2) give employers less of a reason to offer LTD benefits, given the greater potential of overinsurance and the corresponding disincentive for their disabled employees to return to work when able; (3) create market pressures which could result in the reduction of benefits payable under the policy in order to negate the cost impacts of SB 32 and reduce the likelihood of overinsurance; and (4) limit consumer choice in the individual market.

The net effect of SB 32 could be more disabled persons having to exist on no LTD benefits, or on reduced benefits, as they wait many months for Social Security Administration decisions, and the relatively modest replacement rates of SSDI if found to be eligible.

IAC would respectfully suggest that SB 32 would have a detrimental impact on the long term disability insurance marketplace and on the very consumers the bill is intending to help. We know of no other state that has passed or is even considering legislation similar to SB 32.

In fact, just last session the Insurance and Real Estate Committee rejected legislation that would have eliminated certain LTD offsets. Recognizing the negative effects such a prohibition would have on the LTD insurance marketplace and the consumers it serves, the Committee instead established specific disclosure requirements regarding the existence and effects of offsets in group LTD policies. Those disclosure requirements were not and are not necessary for individual LTD policies, given the nature of the individual LTD market (section 2(a) and (b) of SB 32).

IAC urges rejection of SB 32.